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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

Petition for a Writ of Certiorari to the Supreme Court of Virginia

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether this Court's decision in *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

2. Whether the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111 prohibit a state from taxing pensions of military retireees while exempting from taxation the pensions of its own retired employees.

PARTIES TO THE PROCEEDING

Petitioners are 420 civil service and Armed Forces retirees (predominantly members of the Virginia Federation of Chapters of the National Association of Retired Federal Employees and the Military Retirees Taxpayers Association) who have paid state income tax on their federal annuities to the Commonwealth of Virginia. A list of the individual petitioners appears as Appendix D at 17a.

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PETITION FOR A WRIT OF CERTIORARI

Henry Harper and 420 named federal civil service and military retirees [1] hereby petition this Court for a writ of certiorari to the Supreme Court of Virginia.

OPINIONS BELOW

The opinion of the Supreme Court of Virginia (App. B at 2a-12a) is reported at 401 S.E.2d 868. The decision of the trial court, the Circuit Court for the City of Alexandria (App. C at 13a-16a) is unpublished.

JURISDICTION

The Supreme Court of Virginia issued its opinion affirming the trial court and denying petitioners' entitlement to tax refunds on March 1, 1991. App. A at 1a, App. B at 2a. This petition is, accordingly, filed within

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[1] A list of all individual petitioners is attached as Appendix D.

the time allowed by law. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

STATEMENT

In *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989), this Court held that 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity, as derived from the Supremacy Clause, prohibit states from taxing federal annuitants more harshly than state annuitants. The Commonwealth of Virginia, like Michigan and approximately twenty other states, exempted from state income taxation annuities of retired and local employees while taxing annuities of retired federal employees. *See* Code of Virginia § 58.1-322(c)(3) (1984). Petitioners are retired federal employees, both civil service and military, who paid Virginia state income tax on their federal annuities.

Following this Court's decision in *Davis*, petitioners filed tax refund actions in various circuit courts in Virginia. These actions were consolidated before the Circuit Court for the City of Alexandria. Refunds were claimed for tax years 1985, 1986, 1987 and 1988.

The procedural framework in Virginia for a refund action is straightforward. Under state law, taxpayers are entitled to seek refunds of taxes that have been "erroneously or improperly assessed." Code of Virginia § 58.1-1826 (1985). Applications for refunds must be made within three years of the assessment. Code of Virginia § 58.1-1825 (1985). Virginia law contains no "protest" requirement as a prerequisite for tax refund claims. *Id.* Thus, as with the federal system for refund claims, Virginia allows its taxpayers a three-year period during which claims may be made for tax refunds. *See* 26 U.S.C. § 6511(a) (1990) (three-year period for federal tax refund claims).

The Circuit Court for the City of Alexandria denied petitioners' refund claims based upon its view that this

Court's decision in *Davis* was to be applied prospectively-only pursuant to the *Chevron* analysis.[2] App. C at 15a. Petitioners appealed to Virginia's Supreme Court, which affirmed the trial court's analysis and holding. App. A at 1a, App. B at 5a-9a.

CONSTITUTIONAL PROVISION INVOLVED

U.S. Const. amend. XIV provides, in pertinent part:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law . . .

REASONS FOR GRANTING THE PETITION

This case presents questions of substantial public importance concerning the circumstances, if any, under which states may retain taxes that have been imposed in violation of the Constitution and statutes of the United States. Like several cases decided last Term and several pending this Term, this petition questions whether it is a proper judicial function for courts to "apply" decisions of this Court prospectively-only. In other words, this petition challenges the continuing validity of case-by-case retroactivity analysis in civil actions.

This petition also raises the specific question whether this Court's decision in *Davis* v. *Michigan* may in any circumstance be applied in a prospective-only fashion so as to deny tax refunds to federal retirees. Like Virginia and Michigan, approximately twenty other states granted tax preferences to state retirees that were not granted to federal retirees. While refund actions have been brought in each of these states, only two other cases, besides the instant action, have been decided by a state court of last resort. In one case, the court held that refunds must be paid. *Hackman* v. *Director of Revenue*, 771 S.W.2d 77 (Mo. banc 1989), *cert. denied*, 110 S.Ct. 718 (1990). In the other case, the court denied refunds based on the

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[2] *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971).

alleged nonretroactivity of this Court's *Davis* decision. *Bass* v. *South Carolina*, 395 S.E.2d 171 (S.C. 1990), *cert. pending*, U.S. No. 90-673. Lower state courts have split on the question of whether *Davis* must be applied retroactively. Review by this Court is needed to resolve this recurring issue of demonstrated complexity and divisiveness.[3]

1. The court below justified its refusal to order refunds on the basis of a putative "prospective-only" application of this Court's decision in *Davis* v. *Michigan*. That is, the court refused to order refund of the taxes, pretending instead that the taxes were lawful when exacted. Thus, the court below treated *Davis* as if it were not an interpretation of existing constitutional and statutory mandates, but instead as if it represented a new legislative enactment.

To declare that a constitutional mandate "applies" prospectively-only is to decree a new effective date for the Constitution; to declare that a statutory mandate "applies" prospectively-only is to decree a new effective date for the statute. But setting the effective date of constitutional and statutory mandates is simply not a proper judicial function: courts are "to declare what the law is, not to prescribe what it shall be." *American Trucking Ass'ns* v. *Smith*, 110 S.Ct. 2323, 2343 (1990) (Scalia, J., concurring). *See also id.* at 2350 (Stevens, J., dissenting) ("adherence to legal principle requires that we determine the rights of litigants in accordance with our best current understanding of the law"). Decreeing prospectively-only effect to a court decision is nothing short of judicial legislation. *See Mackey* v. *United States*, 401 U.S. 646, 681 (1971); *Desist* v. *United States*, 394 U.S. 244, 259 (1969) (Harlan, J., dissenting). It is not within any court's power to amend the Constitution or a Congressional enactment; similarly it cannot be within any court's power to

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[3] These identical questions are raised in the pending *Bass* petition, U.S. No. 90-673.

decree when a particular provision of the Constitution or a particular statute shall take effect. Such decision-making is utterly and irreconcilably at odds with the judicial role.

This Court has pending, or has recently had before it, nearly a dozen cases challenging the prospective-only application of a decision invalidating state taxes. In all but one case (*Hackman* v. *Department of Revenue*), the state court had refused refunds by denying retroactive effect to the decision invalidating the tax. And notwithstanding that the Court issued four opinions in this area last Term,[4] three cases in addition to this are already before the Court this Term challenging prospective-only application of decisions invalidating state tax schemes.[5]

Review by this Court is needed to provide guidance in this area of recurring litigation. Each case challenging a state tax on federal constitutional or statutory grounds should not have to come before this Court twice—once on the merits and once again on the issue of relief. Extension of the *Griffith* rule[6] to this area of jurisprudence would eliminate this costly and needless second round of litigation. See *American Trucking Ass'ns*, 110 S.Ct. at 2343 (Scalia, J., concurring), at 2350 (Stevens, J., dissenting).

In any event, analysis under *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), has proved unworkable: the steady

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[4] *American Trucking Ass'ns; McKesson* v. *Division of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238 (1990); *National Mines Corp.* v. *Caryl*, 110 S.Ct. 3205 (1990); and *Ashland Oil Co.* v. *Caryl*, 110 S.Ct 3202 (1990).

[5] *James B. Beam Distilling Co.* v. *Georgia*, U.S. No. 89-680; *Norwest Bank Duluth, N.A.* v. *Minnesota Commissioner of Revenue*, U.S. No. 90-645; and *Bass* v. *South Carolina*, U.S. No. 90-673. *See also City of Spokane* v. *United States*, U.S. No. 90-1247 (challenging federal court's refusal to apply decision nonretroactively).

[6] *Griffith* v. *Kentucky*, 479 U.S. 314, 328 (1987), held that new rules of criminal procedure must be applied retroactively to all cases pending on direct review or not yet final.

stream of cases to this Court challenging prospective-only applications demonstrates that the presumption of retroactivity inherent in our jurisprudence [7] has been reversed. So long as state courts have any leeway in determining when to apply this Court's mandates they will be urged to opt for "protective" (*i.e.* nonretroactive) application. *National Can Corp.* v. *Department of Revenue*, 749 P.2d 1286, 1293 (Wash.), *appeal dism'd and cert. denied*, 486 U.S. 1040 (1988). At a minimum, review by this Court is needed to clarify the circumstances in which courts may depart from full restrospective operation of this Court's decisions. Clarity is necessary to assure that prospective-only application, if at all permissible, is indeed the rare exception and not the rule.

This petition, like the *Bass* petition, also presents the separate question of whether the *Chevron* analysis is at all applicable here, a case in which the underlying decision (*Davis* v. *Michigan*) is founded on a statutory interpretation. Congress prohibited state tax discrimination against federal employment compensation over fifty years ago, with passage of the Public Salary Tax Act of 1939, 4 U.S.C. § 111. Yet the court below, under the guise of the "retroactivity" doctrine, purported to change the effective date of the statute to March 29, 1989, the day the *Davis* decision was announced. This usurpation of Congress' exclusive prerogative cannot stand.

2. The specific question presented in this petition, whether refunds of state income tax imposed in violation of 4 U.S.C. § 111 may be denied through a prospective-only application of *Davis* v. *Michigan*, is currently the subject of litigation in approximately twenty states. Some courts have applied the *Chevron* test and concluded that refunds must be paid; other courts have concluded

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[7] *United States* v. *Security Industrial Park*, 459 U.S. 70, 79 (1982) (that "judicial decisions operate retrospectively . . . is familiar to every law student"); *Robinson* v. *Neil*, 409 U.S. 505, 507-08 (1973) ("general rule of retroactivity").

that *Davis* should be applied nonretroactively so as to deny refunds. The question of the prospective/retrospective effect of Supreme Court decisions is ultimately a question of federal law. *Ashland Oil Co., Inc.* v. *Caryl*, 110 S.Ct. at 3204. Review by this Court is needed to conform the divergent opinions of the lower courts on this question.

As noted above, the Supreme Court of Missouri ordered that refunds be paid. *Hackman*, 771 S.W.2d at 81. Similarly, in New Mexico, refunds were mandated pursuant to the state refund statute, with retroactivity of *Davis* given as an alternative basis for refunds. *Burns* v. *New Mexico*, No. SF 89-1314(c) (1st Jud. Dist., Santa Fe County), Letter Decision, April 5, 1990. After this Court's decisions in *American Trucking Ass'ns* and *McKesson*, the State of New Mexico declined to appeal, and has now agreed to pay full refunds. By contrast, South Carolina's Supreme Court, reversing a lower court ruling in favor of refunds, declared the *Davis* decision to be nonretroactive. *Bass* v. *South Carolina*, 395 S.E.2d at 174, *cert. pending*, U.S. No. 90-673.

No other state has finally resolved this issue. However, several trial courts have followed Missouri's lead in awarding refunds:

Alabama, *Rinehart* v. *Sizemore*, No. CV-89-704-M (Cir. Ct. of Montgomery County), Order, October 9, 1990

Arkansas, *Bosnick* v. *Pledger*, No. 89-1451 (Pulaski County Court), Findings of Fact and Conclusions of Law, November 1, 1989

Colorado, *Reimer* v. *Dir. of Dept. of Revenue*, No. 89CV3837 (El Paso County Court), Order, April 13, 1990

Kentucky, *Gossum* v. *Kentucky*, No. 89-CI-248 (Marshall Cir. Ct.), Order, January 4, 1991

Michigan, *Fonger* v. *Dept. of Treasury*, MTT No. 132625 (Michigan Tax Tribunal), Opinion and Judgment, June 11, 1990

Mississippi, *Winstead v. Marx*, No. 141,652 (Chancery Ct., 1st Jud. Dist. of Hines County), Opinion, February 7, 1991, Judgment, April 22, 1991

New York, *Duffy* v. *Wetzler*, No. 7706/89 (S.Ct. of Queens County), Mem. Decision, April 13, 1990

North Carolina, *Swanson* v. *North Carolina*, No. 90CVS03127 (Wake County Superior Court), Decision, Oct. 3, 1990

Utah, *Brumley* v. *Tax Commission*, No. 89-0903618 (Utah Dist. Ct.), Findings, Conclusions and Partial Summary Judgment, April 16, 1991

Appeals are pending or anticipated in each of these cases.[8]

In contrast, other state tribunals have denied all refunds, finding that the *Davis* decision applies prospectively only:

Montana, *Sheehy* v. *Montana*, No. BDV-89348 (Mont.-1st Judicial Court), Order, July 11, 1990

Oklahoma, *Worrell* v. *Oklahoma Tax Commission*, No. DR-016 (Ok. Tax Comm.), Decision April 25, 1991

Oregon, *Ragsdale* v. *Department of Revenue*, No. 2958 (Oregon Tax Court), Decision, November 7, 1990.

Appeals are pending or anticipated in these cases as well.[9]

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[8] In Arizona, the trial court held that full retroactivity of *Davis* was required under the *Chevron* analysis, because the balance of equities favored granting refunds to the extent the federal retirees were harmed by the discrimination. *Bohn* v. *Waddell*, No. TX 89-00050 (Arizona Tax Court), Opinion, April 6, 1990. Yet refunds were limited to the amount of taxes foregone by the state in not taxing their own annuitants rather than the taxes actually paid by the federal retirees. *Id.* at 37, 42-47.

[9] Litigation is ongoing in the following cases: Georgia, *Barto* v. *Collins*, No. 91-D86354 (Fulton County); Iowa, *McManus* v. *Iowa*, No. C89-179 (N.D. Iowa); Louisiana, *Ponthier* v. *Sec. of Dept.*

There is a wide disparity in the conclusions reached and rationales employed by the lower courts in addressing the issue of refunds under *Davis*. When retired federal employees have taken their state law refund claims to state court, the resulting *Davis* retroactivity decisions have left some claimants vindicated, and others subjected to cursory dismissal, based solely upon the state in which the retiree happened to live these past few years. Because resolution of these cases will focus on the retroactivity of *Davis*, the lower courts need a definitive interpretation of this federal question. Review by this Court is thus necessary to conform the diverse results and rationales of the lower courts and provide guidance on this question of substantial importance to numerous states and hundreds of thousands of retired federal employees.

3. The court below declined to give retrospective effect to *Davis*, purportedly "pursuant to" the *Chevron* analysis applied by a plurality of this Court in *American Trucking Ass'ns v. Smith*. App. B at 5a. This issue in particular has created a split among the state courts deciding federal retirees' refund claims. *Compare, e.g., Burns* v. *New Mexico* (*Davis* applies retroactively) *with Bass* v. *South Carolina* (*Davis* applies nonretroactively).

At the outset, the decision below erred in assuming that the plurality opinion in *American Trucking Ass'ns* was intended to apply to a case such as this. The plurality opinion contains two limiting principles that pretermit application of the *Chevron* analysis here.

First, *Davis* involved a question of *statutory* interpretation; specifically, what did Congress mean when it passed the Public Salary Tax Act of 1939? By contrast,

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of Revenue and Taxation, BTA No. 3396 (Board of Tax Appeals), *Ponthier* v. *Broussard*, No. 344-035 (19th Jud. Dist. Ct.); Maryland, *Doneski* v. *Comptroller of Treasury*, No. 3126 (Tax Court); Massachusetts, *Filios* v. *Comm. of Revenue*, No. 171106 (Appellate Tax Board).

the underlying decision at issue in *American Trucking Ass'ns* involved a *constitutional* interpretation; specifically, what is the current reach of the "negative" Commerce Clause. The plurality opinion in *American Trucking Ass'ns* did not purport to address the appropriateness of applying the *Chevron* analysis to a statutory case such as *Davis*, and there are ample grounds to differentiate the Court's role in statutory and constitutional cases. In statutory cases the Court's role is limited to determining what Congress intended when it enacted the law (*Fleming* v. *Fleming*, 264 U.S. 29, 31-32 (1924)), a deferential mode of adjudication mandated by the separation of powers. By contrast, in constitutional cases implicating the Commerce Clause and other "evolving" constitutional doctrines, the Court exercises the broader power to determine what the Constitution *now means* (*Brown* v. *Board of Education of Topeka*, 347 U.S. 483, 492-93 (1954); *Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579, 682 (1952) (Vinson, C.J., dissenting) (the Constitution is a "living document adaptable to new situations;" *citing McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) at 316, 415 and 424 (1819)). Consistent with the Court's deference to congressional intent in a statutory case, statutory interpretations are deemed to "apply" from the effective date of the statute as chosen by Congress.[10] Thus, the plurality opinion in *American Trucking Ass'ns* does not countenance application of the *Chevron* test to this case.

Second, under the analysis in *Cipriano* v. *City of Houma*, 395 U.S. 701 (1969), which figured prominently in *American Trucking Ass'ns*, petitioners are entitled to refunds without consideration of the *Chevron* analysis. In *Cipriano*, the Court held that completed bond elections

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[10] Indeed, the only statutory cases that might be subject to nonretroactive application are those that reverse previous statutory interpretations, an exception without application here. *See United States* v. *Estate of Donnelly*, 397 U.S. 286, 295 (1970).

would stand, and the underlying bond authorizations would be immune from challenge, "where the authorization to issue the securities is legally complete on the date of this decision." 395 U.S. at 706. The Court explained that this "prospective" application of its decision meant that the new rule would apply only to elections "where, under state law, the time for challenging the election result has not expired, or in cases brought within the time specified by state law for challenging the election and which are not yet final." *Id.* Because there was no statutory refund entitlement in Arkansas, *American Trucking Ass'ns* v. *Gray*, 483 U.S. 1306, 1309 (1987) (in chambers), the plurality opinion in *American Trucking Ass'ns* viewed the annual highway use taxes as transactions immune from challenge under state law. 110 S.Ct. at 2339. But in this case, the tax assessments in question remain assailable pursuant to Virginia state law until petitioners' three-year refund period has ended. *See* Code of Virginia § 58.1-1825. Thus, consistent with the plurality decision in *American Trucking Ass'ns*, and pursuant to *Cipriano*, the *Davis* decision applies to this case without recourse to the *Chevron* analysis.

In any event, even if the *Chevron* analysis is found to apply here, the result reached by the court below is an untenable application of that analysis. Under the facts of this case, none of the *Chevron* factors is satisfied.

a. As a threshold matter, full retroactivity must be accorded to a decision of this Court unless the decision in question "establish[es] a new principle of law." *Chevron*, 404 U.S. at 106. If a decision by this Court is a "surprise" or a "bolt from the blue" (*Graves* v. *Smith Transfer Corp.*, 736 F.2d 819, 821 (1st Cir. 1984)), then the first *Chevron* factor is satisfied, and the remainder of the *Chevron* test must be applied; conversely, if a decision does not "break" from past precedent, then the decision necessarily applies retroactively. *See United States* v. *Johnson*, 457 U.S. 537, 550 and n.12 (1982); *McKes-*

son, 110 S.Ct. at 2247 n.15; *Ashland Oil* v. *Caryl*, 110 S.Ct. at 3204.

Logic dictates that a decision such as *Davis*, founded as it is upon a statute passed in 1939, could rarely, if ever, satisfy the threshold *Chevron* test. In *Davis*, this Court applied the Public Salary Tax Act of 1939 (4 U.S.C. § 111) to the discriminatory taxation here at issue, and found the state's disfavored treatment of federal retirees to be unlawful. 489 U.S. at 817. It follows that any "new principle of law" implicated in *Davis* (if indeed there was one) was announced not by this Court in 1989, but by Congress in 1939. *Compare American Trucking Ass'ns* v. *Smith*, 110 S.Ct. at 2331-32 (threshold *Chevron* test satisfied where the Court has reversed direction in its constitutional interpretation of the "negative" Commerce Clause). Statutory language enacted in 1939 did not arrive like a "bolt from the blue" in *Davis*.

In any event, the court below held that *Davis* satisfied the threshold *Chevron* test because *Davis* "established a new rule of law by deciding an issue of first impression whose resolution was not clearly foreshadowed." App. B 7a. Other than this incantation, the court below merely asserted that "it is difficult to discern how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation." *Id.* These holdings by the court below betray a complete misapprehension of the nature of *Chevron's* threshold test.

The holding in *Davis* followed naturally and unexceptionally from settled law. That retirement benefits constituted "deferred compensation" (and thus "pay or compensation for personal service as an officer or employee of the United States," 4 U.S.C. § 111), was established by Congressional intent in 1920 (*see, e.g.*, 59 Cong. Rec. 6300 (April 29, 1920) (statement of Rep. Hamill: federal pensions "should be looked upon as deferred

wages")), and routinely confirmed in judicial decisions such as *Kizas* v. *Webster*, 707 F.2d 524, 536 (D.C. Cir. 1983), *cert. denied*, 464 U.S. 1042 (1984).[11] The second aspect of the *Davis* decision, that the differential tax treatment of federal and state retirement benefits amounted to "discrimination" under 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity, was no longer in question following *Phillips Chemical Co.* v. *Dumas*, 361 U.S. 376 (1960), and *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392 (1983).[12]

In truth, not a single new principle of law was established in *Davis*. *See Rinehart*, *supra* at 4 (*Davis* was "inevitable"). The Court in *Davis* did no more than take the statute enacted by Congress in 1939, recognize the applicable definition of "discrimination" set forth in *Phillips Chemical* in 1960, and apply it to the facts of Michigan's tax scheme. A case, such as *Davis*, that "simply appl[ies] settled precedent to a new set of facts" fails the threshold *Chevron* test. *United States* v. *Johnson*, 457 U.S. at 551. *See also Ashland Oil Co., Inc.* v. *Caryl*, 110 S.Ct. 3202, 3205 (1990) (predicate for arguably revolutionary decision is entitled to full retroactive application).[13]

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[11] Indeed, even the Attorney General of Virginia recognized in 1953 that retirement annuities constituted an "emolument" of federal service. *See Opinions of the Attorney General and Report to the Governor of Virginia* 184 (1953) (opinion F-249(220), dated March 16, 1953).

[12] As stated in *Phillips Chemical Co.*, 361 U.S. at 385: "it does not seem too much to require that the State treat those who deal with the [federal] government as well as it treats those with whom it deals itself." *See Davis*, 489 U.S. at 815 n.4.

[13] In *City of Spokane* v. *United States*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. pending*, U.S. No. 90-1247, full retroactive effect was accorded to a decision striking down a municipal tax levied against a Red Cross organization. The court properly determined that the threshold *Chevron* test (establishment of a "new principle of law") could not be satisfied because the court's decision invalidat-

b. The second *Chevron* factor calls for courts to evaluate the purpose and effect of the legal rule in question and ascertain whether retrospective operation will further or retard the rule's operation. *Chevron*, 404 U.S. at 106. The court below summarily found that Virginia had satisfied this factor because the Commonwealth had repealed the statute in question. App. B at 7a. Yet this analysis says nothing: this Court in *Davis* invalidated the statute irrespective of whether the Virginia General Assembly repealed it or not. Further, the court below merely begged the question by finding that "Virginia's taxing statute was legitimate until a new rule was announced in *Davis*." *Id.*

Other than resorting to these tautologies, the decision below found nothing to suggest that retroactive application of *Davis* would *retard* the operation of the Supremacy Clause. Moreover, it ignored the ways in which retroactive application of *Davis* furthers the purposes of the Supremacy Clause.

First, central to the Supremacy Clause is the tenet that federal statutory enactments supervene contrary state laws. *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). *Davis* rested not only upon the constitutional principle of intergovernmental tax immunity, but also upon the unambiguous force of the Public Salary Tax Act of 1939, 4 U.S.C. § 111. *Davis*, 489 U.S. at 807-14. The court below, by asserting the nonretroactivity of *Davis*, has effectively held that 4 U.S.C. § 111 did not apply in Virginia until March 28, 1989 (when this Court decided *Davis*), fifty years after Congress passed the statute. Delaying the effective date of federal legislation is beyond the power of state courts and legislatures. *See McCulloch*

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ing the tax had "proceed[ed] from a long, if somewhat wavy, line of Supreme Court authority." *Id.* If a *wavy* line of precedent supports a finding of retroactivity, then the *direct* line of precedent on which *Davis* is founded (*i.e.*, 4 U.S.C. § 111 and *Phillips Chemical Co.*) necessarily mandates a finding of retroactivity.

v. *Maryland*, 17 U.S. (4 Wheat.) at 439 ("States have no power by taxation or otherwise to reduce or impede powers vested in the general government."). Retroactivity of *Davis*, therefore, would directly further the fundamental Supremacy Clause principle that federal statutes upon enactment are the supreme law of the land.

Second, the intergovernmental tax immunity doctrine, at its core, dictates that states may not subsidize their operations through taxation of federal entities. Here, the Commonwealth's tax scheme caused the federal government to subsidize state retirement benefits. As this Court held in *Davis*:

> Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

489 U.S. at 815 n.4. Retraction of that unlawful subsidy through retroactivity of *Davis* would directly effectuate the legal principle underlying the doctrine of intergovernmental tax immunity. *Compare American Trucking Ass'ns*, 110 S.Ct. at 2332 (retroactivity not necessary to effectuate purposes of Commerce Clause).

Third, to allow the states to retain unconstitutionally exacted taxes provides them with a naked financial incentive to collect taxes aggressively even where, as here, the tax causes unconstitutional financial harm to the federal treasury, and well-settled legal principles expose the illegality of the tax at the time it is collected. So long as a state may take refuge in prospective-only application of decisions invalidating its tax schemes, it will be encouraged to tax beyond constitutional limits. Retroactive application of *Davis* would extinguish this financial incentive for unconstitutional taxation.[14]

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[14] The court below permitted the Commonwealth to retain taxes assessed *after Davis* was announced. In Virginia, income tax self-assessments are deemed "made" and "filed" on the first day of May

Finally, retroactive application of *Davis* will cause refunds to be made to petitioners, and this will directly advance the purposes of the Supremacy Clause and the principle of intergovernmental tax immunity. As to petitioners themselves, they have legitimate compensatory interests safeguarded by the Supremacy Clause. *See, e.g. Green* v. *Mansour*, 474 U.S. 64, 69 (1985) ("Remedies designed to end a continuing violation of federal law are necessary to vindicate the federal interest in assuring the supremacy of the law"). More importantly, the United States government presumably stands to obtain perhaps one-fourth or more of the refunds made to federal retirees, based upon the federal taxability of such refunds. While retroactive application of *Davis* will not allow the federal government to recoup all the involuntary and unconstitutional subsidy it has been paying to Virginia and other states for almost half a century, it will at least provide some recompense to the federal fisc. This recovery of improper subsidies would plainly further the purposes of the intergovernmental tax immunity doctrine.

c. The third *Chevron* factor calls for balancing the equities of prospective-only versus retroactive application of the decision. The court below concluded that this balance favored prospective-only application of *Davis* because "allowing the requested refunds would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." App. B at 9a. The court did not

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following the tax year in question. Code of Virginia 58.1-1820(2). This Court's decision in *Davis* invalidating the discriminatory tax in question was announced on March 29, 1989. Any discriminatory tax assessments made after that date were clearly contrary to supreme federal law. Nevertheless, the court below permitted the Commonwealth to retain petitioners' May 1, 1989 tax assessments, despite the plain invalidity of such taxes. This overreaching by the court below is indicative of the lengths to which states have gone to maximize questionable taxation at the expense of federal retirees and the federal fisc.

explain how this financial burden could be any heavier on the state, and all its taxpayers, than on the select minority of taxpayers who had unconstitutionally been forced to shoulder this burden. Instead of *balancing* equities, the court below adopted the Commonwealth's equitable plea *in toto*, without addressing the equitable weight of the federal retirees' refund claims.[15]

With the possible exception of cases involving overturning of Supreme Court precedent, *see American Trucking Ass'ns*, 110 S.Ct. at 2334, as a matter of federal law, the equities favor the citizen's compensatory interests over that of a governmental entity. As stated in *Owen* v. *City of Independence*, 445 U.S. 662, 655 (1980):

> even where some constitutional development could not have been foreseen by municipal officials, it is fairer to allocate any resulting financial loss to the inevitable costs of government borne by all the taxpayers, than to allow its impact to be felt solely by those whose rights, albeit newly recognized, have been violated.

Federal law aside, it is simply more equitable to place the financial consequences of an unconstitutional income tax upon the government (and thus the citizenry as a whole) than upon a select subclass of taxpayers who had unconstitutionally been forced to pay the tax in the first instance.

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[15] The court below quotes the following language from *Lemon* v. *Kurtzman*, 411 U.S. 192 (1973), as if it supported the equity of nonretroactive application of *Davis*: "statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct." 411 U.S. at 199. See App. B at 8a. But the Commonwealth can point to no statutory or judge-made rules of law, or any other "hard facts," on which it could have relied in retaining petitioners' taxes from 1985 to 1988. Indeed, if anything, petitioners were entitled to rely on the "hard fact" that Congress had enacted 4 U.S.C. § 111 to prohibit such tax discrimination, and the "hard fact" that Virginia's tax laws purport to provide taxpayers with three years in which to request refunds of improper assessments.

Further, no equitable weight should be accorded to the potential budget "disruption" feared by the Commonwealth and relied upon by the court below. Like the federal government and virtually every other state, Virginia has adopted a tax refund system that explicitly accepts several years of budgetary uncertainty. As provided by Virginia Code § 58.1-1825, "[a]ny person assessed with any tax administered by the Department of Taxation and aggrieved by any such assessment may . . . within three years from the date such assessment is made, apply to a circuit court for relief." *See also* 26 U.S.C. § 6511(a) (three year refund period for federal taxes). In other words, the Commonwealth's own laws mandate a period of budget uncertainty during the three years each tax dollar takes to "clear" the refund period.[16]

At bottom, the holding below derives from a belief that the Commonwealth is just too poor for *Davis* to be held retroactive. But the purported magnitude of the refund claims cannot add any substance to Virginia's equitable plea. It is indeed a perverse suggestion that the larger the magnitude of its constitutional violation, the greater the Commonwealth's equitable claim not to remedy it. The court below erred in adopting a rationale so deeply and fundamentally flawed.

4. In the court below, the Commonwealth sought to distinguish between civil service retirees and retirees of

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[16] Further undercutting the Commonwealth's purported fear of budgetary disruption is the report that the Governor of Virginia has set aside and continues to preserve a budgetary "rainy-day-fund" of $200 million, the purpose of which is to cover federal retirees' probable refund claims. *See* Wash. Post, March 2, 1991, § B, at 3, col. 5 ("The potential cost of the [retirees'] lawsuit was cited by Gov. L. Douglas Wilder during the recent legislative session as one of the reasons for retaining a $200 million rainy-day fund in the current budget."); *id.*, July 12, 1990, § D, at 4, col. 3 ("[Gov.] Wilder and the General Assembly established a $200 million "rainy day" fund this year that could help reduce future deficits, but the governor has said he would like to hold that fund for unforeseen fiscal problems.").

the Armed Forces. The Commonwealth argued that because of the putative differences in the nature of civil service and military retirement, it could deny refunds to military retirees even if it were compelled to grant refunds to civil service retirees. That is, the Commonwealth argued that it did not violate 4 U.S.C. § 111 by taxing military pensions while exempting state pensions.

The court below did not reach this argument due to its application of the *Chevron* analysis. Yet this argument has also been raised in a number of states other than Virginia. *See e.g., Barker* v. *Kansas*, No. 89-CV666 (D.Ct. Shawnee County Oct. 31, 1990), *appeal pending*; *Reimer* v. *Director of Dep't of Revenue*, No. 89-CV3837 (El Paso County Apr. 13, 1990), *appeal pending*. This Court should grant certiorari to decide this pure question of law that continues to be litigated in several states.

The crux of the putative distinction between military pensions and civil service pensions is that certain military retirees are subject to recall and thus their annuities supposedly represent "reduced current pay for reduced current services." *Barker* v. *Kansas, supra* at 9. This putative distinction, however, is inapposite for purposes of 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine.

Discriminatory taxation of military annuities could only stand if there were a "significant difference" between the state annuities exempted and the military pensions taxed. *Davis*, 489 U.S. at 815. There is not. Military pensions, like Virginia's pensions, are computed on the basis of length of service and pay while employed. 10 U.S.C. §§ 1401-1405. Moreover, while social security taxes, the *sine qua non* of wages, are payable on both state and military pay, it is withheld from neither state nor military annuities. 26 U.S.C. § 3121(i)(2). Thus there is no significant difference in the way federal law treats military and state annuities.

Similarly, state laws, including Virginia's, treat military retirement payments in parity with state pensions. In domestic relations matters, for example, Virginia treats military pensions as part of the marital estate to be apportioned on the basis of the number of years in which the parties were married while the pension was earned. *Steinberg* v. *Steinberg*, 398 S.E.2d 507, 508 (Va. App. 1990); *Clements* v. *Clements*, 397 S.E.2d 257, 258 (Va. App. 1990). If, as the Commonwealth has argued, military retired pay were compensation for current services, then it could only be treated as a source of income, not as marital property. *Cf. Lambert* v. *Lambert*, 395 S.E.2d 207, 209 (Va. App. 1990) (refusing to divide veterans benefits, which represented compensation for loss of earning capacity, as marital property).

Additionally, many states, including Virginia, impose a "source tax" on military and civil service retirement. *See* 18 BNA Pension Reporter 49 (Jan. 14, 1991) (reporting on H.R. 431, a bill to ban states from levying taxes on former residents' pensions). That is, these states tax pensions received by individuals who currently reside outside the state, but whose pensions were earned while living within the state. The imposition of this tax presupposes that retirement is deferred compensation earned while living within the state, not current compensation earned where the retiree currently resides. Thus, to the extent that military retirees are subject to "source taxes" on their annuities, they are being treated as receiving deferred compensation. Accordingly, there are no significant differences between military and civil service annuities; indeed, for purposes of 4 U.S.C. § 111, they are indistinguishable.

For these reasons, petitioners submit that there is no viable distinction between military and civil service pensions for purposes of 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine. Accordingly, this Court should grant the petition to resolve this additional issue.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the Supreme Court of Virginia should be granted.

Respectfully submitted,

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May 3, 1991

APPENDICES

APPENDIX A

VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Friday the 1st day of March, 1991.

Record No. 900770

Circuit Court Nos. CL890462, CL890463 and CL891079 through CL891081

HENRY HARPER, *et al.*,
Appellants,

against

VIRGINIA DEPARTMENT OF TAXATION,
Appellee.

Upon an appeal from a judgment rendered by the Circuit Court of the City of Alexandria on the 12th day of March, 1990.

For reasons stated in writing and filed with the record, the Court is of opinion that there is no error in the judgment appealed from. Accordingly, the judgment is affirmed. The appellants shall pay to the appellee thirty dollars damages.

This order shall be certified to the said circuit court.

A Copy,

Teste:

/s/ [Illegible]
Clerk

APPENDIX B

SUPREME COURT OF VIRGINIA

Record No. 900770

HENRY HARPER, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

Record No. 900792

LAWRENCE E. LEWY, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

From the Circuit Court of the City of Alexandria
DONALD H. KENT, Judge

Present: Carrico, C.J., Compton, Stephenson, Whiting, Lacy, and Hassell, JJ., and Cochran, Retired Justice

OPINION BY JUSTICE ROSCOE B. STEPHENSON, JR.

March 1, 1991

In *Davis* v. *Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court of the United States declared that state taxation of pension income of retired federal government employees, while exempting from taxation pension income of retired state government employees, violated the doctrine of intergovernmental tax immunity embodied in the supremacy clause of the Constitution of the United States. The Supreme Court, however, did not decide whether its decision in *Davis* had retrospective application.[1]

In these consolidated appeals, the appellants (collectively, Harper) are retired federal employees who receive either civil service retirement benefits or military retired pay. They filed suits in the trial court against the Virginia Department of Taxation (the Commonwealth) in May 1989, seeking refunds, pursuant to Code § 58.1-1826, for state income taxes paid for tax years 1985, 1986, 1987, and 1988. After consolidating the several suits, the trial court ruled that *Davis* should be applied prospectively only and, therefore, that Harper was not entitled to the refunds. Harper appeals.

In this appeal, the principal issue is whether *Davis* should be applied only prospectively, thereby denying the refunds, or retroactively, thereby granting the refunds.

I

Whether a constitutional decision of the Supreme Court is applied retroactively is a matter of federal law. *American Trucking Associations, Inc.* v. *Smith*, —— U.S. ——, ——, 110 S.Ct. 2323, 2330 (1990). In the civil context, retroactive application of such decisions is governed by the three-pronged test announced in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971). *Smith*, ——

[1] The Supreme Court did not consider this issue because Michigan conceded that "to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." *Davis*, 489 U.S. at 817.

U.S. at ——, 110 S.Ct. at 2331, *see U.S.* v. *Johnson*, 457 U.S. 537, 563 (1982).

In *Smith*, the Supreme Court considered a state's taxing statute that previously had been declared unconstitutional under the commerce clause of the Federal Constitution. —— U.S. at ——, 110 S.Ct. at 2329. The Court denied the claimant's request for a refund of taxes paid prior to an earlier decision that invalidated the taxing statute. *Id.* at ——, 110 S.Ct. at 2334. In so doing, a plurality of the Court employed the three-pronged *Chevron* test and concluded that its earlier decision should not be applied retroactively. The Court found that its earlier decision invalidating an Arkansas highway tax, *American Trucking Assns., Inc.* v. *Scheiner*, 483 U.S. 266 (1987), established a "new principle of law" under the commerce clause. *Id.* at ——, 110 S.Ct. at 2332. Arkansas's legislature, therefore, was justified in relying upon existing precedent and had "good reason to suppose" the enactment of the tax would not violate the Federal Constitution. *Id.* at ——, 110 S.Ct. at 2333.

Harper contends, nonetheless, that "because the taxes at issue here . . . constitute[d] an 'unconstitutional deprivation,' . . . Virginia must provide "backward-looking relief' to the refund claimants." Harper asserts that such relief is required by the holding in *McKesson Corp.* v. *Division of Alcoholic Beverages and Tobacco*, —— U.S. ——, 110 S.Ct. 2238 (1990).

In *McKesson*, decided on the same day as *Smith*, the Supreme Court held that a "clear and certain remedy," which could include refunds, was required to remedy Florida's unconstitutional liquor tax statute. —— U.S. at ——, 110 S.Ct. at 2252. In so holding, the Court rejected Florida's contention that its taxing authority implemented the tax preference scheme " 'in good faith reliance on a presumptively valid statute.' " *Id.* at ——, 110 S.Ct. at 2254. In rejecting that contention, the Court stated that the challenged tax statute "reflected only

cosmetic changes from the prior version of the tax scheme that itself was virtually identical to the Hawaii scheme invalidated" in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984). Thus, the Court concluded, Florida "[could] hardly claim surprise" when its later statute was invalidated. *Id.* at ——, 110 S.Ct. at 2255.

In the present case, nothing in the record suggests that the Commonwealth acted other than in good faith reliance upon a presumptively valid taxing statute. We conclude, pursuant to *Smith*, that the three-pronged *Chevron* test must be employed to determine whether the *Davis* decision should be applied prospectively only.

A

For a decision to be applied prospectively only, the first prong of the *Chevron* test requires that the decision "establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." 404 U.S. at 106. Satisfaction of this first prong usually has been stated as the "threshold test" for determining whether or not a decision should be applied prospectively only. *Johnson*, 457 U.S. at 550 n.12.

When *Davis* was decided, 23 states had statutes similar to the Michigan statute.[2] Virginia's statute had been in

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[2] *See* Ala. Code Sections 36-27-28 and 40-18-19 (Supp. 1988); Ariz. Rev. Stat. Ann. Section 43-1022 (Supp. 1988); Ark. Code Ann. Section 26-51-3206; Colo. Rev. Stat. Section 39-22-104(4)(f) and (g) (Supp. 1988); Ga. Code Ann. Section 48-7-27(a)(4)(A) (Supp. 1988); Iowa Code Ann. Section 97A.12 (West 1984); Kan. Stat. Ann. Section 74-4923(b) (1985); Ky. Rev. Stat. Ann. Section 16.690 (Michie/Bobbs-Merrill Supp. 1988); La. Rev. Stat. Ann. 47:44.1 (Supp. 1989); Mich. Comp. Laws Ann. Section 206.30 (1988); Miss. Code Ann. Section 25-11-129 (1972); Mo. Rev. Stat. Section 86.190 and 104.540 (1986); Mont. Code Ann. Section 15-30-

effect for almost half a century. *See* Acts 1942, c. 325. As far as the record shows, the federal pensioners had paid the tax without protest. Not a single federal pensioner had brought an action during that period in a Virginia court seeking a refund of taxes on the basis of the intergovernmental tax immunity doctrine. The absence of such litigation reasonably may be explained by examining the doctrine's origin and development.

The intergovernmental tax immunity doctrine had its genesis in *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). The doctrine was grounded on the proposition that "[s]tates have no power, by taxation or otherwise, to retard, impede, burden or in any other manner control, the operations [of the federal government]." *Id.* at 436.

The pre-*Davis* cases invalidating state taxing statutes were decided on the proposition that the tax had a foreseeable and direct effect on some operation of the federal government. *See, e.g., Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392 (1983) (state tax that imposes greater burden on holders of federal obligations than on holders of similar state obligations impermissibly discriminates against securities issued by federal government); *Phillips Chemical Co.* v. *Dumas Indep. Sch. Dist.*, 361 U.S. 376 (1960) (state tax that imposes greater burden on lessees of federal property than on lessees of other exempt public property impermissibly discriminates against federal government). Indeed, *Davis* states that intergovernmental tax immunity is based on "the need to

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111(2) (1987); N.M. Stat. Ann. Section 10-11-145 (1978); N.Y. Tax Law Section 612(c)(3) McKinney (1987); N.C. Gen. Stat. Section 135-9 (1988); Okla. Stat. tit. 68 § 2358 (1988); Ore. Rev. Stat. Section 316.680(1)(c) and (d) (1987); S.C. Code Section 12-7-435(a), (d), and (e) (Supp. 1988); Utah Code Ann. Section 49-1-608 (1989); Va. Code Section 58.1-322(C)(3) (Supp. 1988); W.Va. Code Section 11-21-12(c)(5) and (6) (Supp. 1988); Wis. Stat. Section 71.05(1)(a) (Supp. 1988).

protect each sovereign's governmental operations from undue interference by the other." 489 U.S. at 814.

In the present case, it is difficult to discern how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation. Consequently, we conclude that the *Davis* decision established a new rule of law by deciding an issue of first impression whose resolution was not clearly foreshadowed. Thus, the first prong of the *Chevron* test is satisfied.

B

The second *Chevron* prong requires a court to "weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." 404 U.S. at 106-07. In applying this factor, we must determine whether the intergovernmental tax immunity doctrine will be retarded or furthered by retroactive application of the *Davis* decision.

The purpose of intergovernmental tax immunity is not to prevent legitimate state taxation. *See Smith*, —— U.S. at ——, 110 S.Ct. at 2332. Virginia's taxing statute was legitimate until a new rule was announced in *Davis*. As soon as the General Assembly became aware of the *Davis* decision, it acted to correct the defects in its statute. *See* Acts 1989, Special Session II, c. 3. As a result, the purpose of the intergovernmental tax immunity doctrine already has been fully served, and applying *Davis* retroactively would do nothing either to retard or to further the doctrine's purpose. Therefore, the second prong of the *Chevron* test is satisfied.

C

The third prong of the *Chevron* test requires a court to "[weigh] the inequity imposed by retroactive application." 404 U.S. at 107. In weighing the equities, con-

siderable deference must be accorded a state's reliance upon a statute that was presumptively valid. *See Lemon* v. *Kurtzman*, 411 U.S. 192 (1973). Indeed, "[i]t is well established that reliance interests weigh heavily in the shaping of an appropriate equitable remedy." *Id.* at 203. As Chief Justice Burger so aptly stated in *Lemon*, "statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity." *Id.* at 199.

An important equitable consideration is the effect that retroactive application of a judicial decision may have on a state's financial stability. As the *Smith* plurality acknowledged, applying a judicial decision retroactively may "have potentially disruptive consequences for the State and its citizens. A refund, if required by state or federal law, could deplete the state treasury, thus threatening the State's current operations and future plans." —— U.S. at ——, 110 S.Ct. at 2333.

In *Arizona Governing Committee* v. *Norris*, 463 U.S. 1073, 1105 (1983), the Supreme Court held that the State of Arizona's voluntary pension plan violated Title VII of the Civil Rights Act of 1964. The Court further held, however, that the state's liability would be prospective only. *Id.* The Court found that retroactive liability could cost the state hundreds of millions of dollars. As Justice Powell stated, "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Id.* at 1106-07. Because the illegality of Arizona's actions had not been declared until *Norris* was decided, Justice Powell further stated that "[t]here is no justification for this Court . . . to impose this magnitude of burden retroactively on the public." *Id.* at 1107.

In the present case, the record discloses that retroactive application of the *Davis* decision would give rise

to a potential tax refund liability, inclusive of interest, of approximately $440,000,000. This liability would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits. The record contains affidavits of Commonwealth officials that support the conclusion that allowing the requested refunds would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services.

Harper contends, nonetheless, that "it is simply more equitable to place the financial consequences . . . upon the government (and thus the whole body of taxpayers) than upon a small subclass of taxpayers who had unconstitutionally been forced to pay the tax in the first instance." Thus, Harper asserts, "taxpayers who have been paying more than their lawful share of taxes should be reimbursed by those who have paid less."

The Commonwealth counters by pointing out that "hundreds of thousands of other Virginia taxpayers have paid taxes on their private pension income but have no claim for monetary relief." The Commonwealth further asserts that "over 2.5 million Virginians annually have paid their 'fair share' of taxes while only some sixty thousand state and local retirees were excluded from pension income taxation."

The record supports the Commonwealth's assertions, and we conclude that, on balance, the equities weigh heavily in favor of the Commonwealth. Consequently, the third prong of the *Chevron* test is satisfied.

Accordingly, we hold that, under the *Chevron* test, the *Davis* decision is not to be applied retroactively. *Accord Bass* v. *State*, 395 S.E.2d 171 (S.C. 1990).

II

Harper contends, nonetheless, that the refunds are due as a matter of state law. He relies upon Code §§ 58.1-1825 and -1826. Code § 58.1-1825 provides that "[a]ny

person assessed with any tax administered by the Department of Taxation and aggrieved by any such assessment may . . . within three years from the date such assessment is made, apply to a circuit court for relief." Code § 58.1-1826 provides, in pertinent part, as follows:

> If the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order that the assessment be corrected. If the assessment exceeds the proper amount, the court may order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the court shall order that the applicant pay the proper taxes and to this end the court shall be clothed with all the powers and duties of the authority which made the assessment complained of as of the time when such assessment was made and all the powers and duties conferred by law upon such authority between the time such assessment was made and the time such application is heard. The court may order that any amount which has been improperly collected be refunded to such applicant.

Harper asserts that, even if the *Davis* decision applies prospectively only, the federal retirees are entitled to refunds under Code § 58.1-1826. Harper argues that, because the assessments are unconstitutional, they also are "erroneous or improper."

We reject this argument. We hold that, because the *Davis* decision is not to be applied retroactively, the pre-*Davis* assessments were neither erroneous nor improper within the meaning of Code § 58.1-1826.

Harper's state-law contention also fails for another reason. We previously have held that this Court's ruling declaring a taxing scheme unconstitutional is to be applied prospectively only. *Perkins* v. *Albemarle County*, 214 Va.

240, 198 S.E.2d 626, *aff'd and modified on rehearing*, 214 Va. 416, 200 S.E.2d 566 (1973).[3] We adhere to our holding in *Perkins*. In so doing, we follow the criteria stated in *Fountain* v. *Fountain*, 214 Va. 347, 348, 200 S.E.2d 513, 514 (1973), *cert. denied*, 416 U.S. 939 (1974), that "consideration should be given to the purpose of the new rule, the extent of the reliance on the old rule, and the effect on the administration of justice of a retroactive application of the new rule." *See also Quick* v. *Harris*, 214 Va. 632, 634, 202 S.E.2d 869, 871 (1974), *cert. denied*, 420 U.S. 907 (1975).

III

Finally, Harper contends that "even if *Davis* were applied prospectively only, refunds for 1988 taxes would nonetheless be due, for they were not assessed, and in many cases were not paid, until *after Davis* was decided." (Emphasis in original.) *Davis* was decided on March 28, 1989. The last day for filing individual income tax returns for the 1988 taxable year was May 1, 1989. Harper claims that the last day for filing income tax returns is the date on which income taxes are assessed for the preceding year.[4] We do not agree.

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[3] The case of *Capehart* v. *City of Chesapeake*, No. 5459 (Circuit Court, City of Chesapeake, decided Oct. 16, 1974), followed *Perkins*. In *Capehart*, more than one hundred taxpayers in the City of Chesapeake, who had been subjected to the same practice that was invalidated in *Perkins*, brought suit in circuit court seeking, among other things, refunds of the taxes "illegally and unconstitutionally assessed." The City demurred, citing *Perkins*. The circuit court sustained the demurrer, being of opinion that the case was controlled by *Perkins*. We denied Capehart's petition for appeal, 215 Va. xlvii, and Capehart's petition for certiorari raising due process grounds was denied by the Supreme Court, 423 U.S. 875 (1975).

[4] Harper's reliance upon Code § 58.1-1820 is misplaced. Section 58.1-1820 defines "assessment" as that term is used in Article 2 of Chapter 18, which establishes limitation periods for various forms of relief. Individual income tax liability is established in Article 2 of Chapter 3.

Income taxes are "imposed on the Virginia taxable income *for each taxable year* of every individual." Code § 58.1-320. (Emphasis added.) The taxable year ended on December 31, 1988, almost three months before *Davis* was decided. When the year ended, the 1988 tax was fixed and ascertainable. Only payment of the tax was delayed until May 1, 1989. Code § 58.1-341.

The Supreme Court rejected a similar contention in *Smith*. The Court reasoned that tax liability depends upon the " 'occurrence of the taxed transaction or the enjoyment of the taxed benefit, not the remittance of the tax.' " *Smith*, —— U.S. at ——, 110 S.Ct. at 2335. As Justice O'Connor observed,

> [a] contrary rule would give States a perverse incentive to collect taxes far in advance of the occurrence of the taxable transaction. It would also penalize States that do not immediately collect taxes, but nevertheless plan their operations on the assumption that they will ultimately collect taxes that have accrued.

Id. at 2336.[5]

In sum, we hold that, (1) under the *Chevron* test, the *Davis* decision is not to be applied retroactively, (2) state law does not require tax refunds, but to the contrary, grants prospective-only application to decisions that invalidate a taxing scheme, and (3) our denial of refunds includes taxes due for the tax year 1988. Accordingly, the trial court's judgment will be affirmed.

Record No. 900770—*Affirmed*,

Record No. 900792—*Affirmed*.

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[5] For the same reason, we reject the contention in *Lewy* (Record No. 900792) that the trial court erred in denying injunctive relief that would have barred the Commonwealth from filing any action to collect taxes from those who, after the *Davis* decision, had refused to pay the 1988 taxes.

APPENDIX C

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

Law No. CL891080

HENRY HARPER, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL890462

JOHN and FRANCIS MORRIS,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL890463

GEORGE and HELEN RABIL,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL891079

LAWRENCE and MIRIAM LEWY, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL891081

RAYMOND S. WEBSTER, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant.

ORDER

These five tax refund actions filed under Va. Code § 58.1-1825 and § 58.1-1826 against the Virginia Department of Taxation were heard and decided together upon the suggestion of the parties. The matter is presently before the Court on Cross-Motions for Summary Judgment filed by the defendant and the individual federal retiree plaintiffs in each case, the parties having agreed there are no material facts which are genuinely in dispute. Upon consideration of the pleadings and memoranda submitted by the parties, the affidavits filed by the plaintiffs and defendant and made part of the record by agreement of the parties, and the oral arguments heard by the Court on February 2, 1990, the Court, in accordance with its letter opinion dated February 12, 1990, rules as follows:

In each of these cases, the Court finds that the taxes challenged by plaintiffs were imposed under a valid stat-

ute which was not called into question until the United States Supreme Court decided *Davis v. Michigan Department of Treasury,* 109 S.Ct. 1500 (1989). The question before this Court is whether this is an appropriate case for prospective application of an unprecedented judicial decision. The determination of the retroactivity of judicial decisions is governed by the factors set forth in *Chevron Oil Co. v. Huson,* 404 U.S. 97 (1971):

- *Davis* decided an issue of first impression whose resolution was not clearly foreshadowed;
- prospective application of *Davis* will not retard its operation; and
- retroactive application would result in inequity, injustice and hardship.

It is clear to the Court that all of these factors are met in the present case, and that the *Davis* decision does not apply retroactively. This being so, the Court holds that:

- the taxes complained of were not erroneous or improper;
- plaintiffs therefore are not entitled to the requested refunds for taxable years 1985 through 1988.

Accordingly, it is hereby ORDERED that defendant's Motion for Summary Judgment is GRANTED, and plaintiffs' Motions for Partial Summary Judgment are DENIED. The provisions of Rule 1:13 shall be dispensed with except as to Michael J. Kator, Esquire, admitted *pro hac vice* in these proceedings as counsel for all plaintiffs, and local counsel George J. Rabil, Esquire. The Clerk of this Court is directed to reflect in the record in each of these cases that judgment is entered in favor of the defendant; and to mail an attested copy of this Order to all counsel of record.

Enter this 12th day of March, 1990.

/s/ Donald H. Kent
DONALD H. KENT
Judge

Seen and agreed to:

/s/ Gail Starling Marshall
GAIL STARLING MARSHALL
Deputy Attorney General

BARBARA M. ROSE
Senior Assistant Attorney General

GREGORY E. LUCYK
Assistant Attorney General

Office of the Attorney General
101 North Eighth Street
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Counsel for Defendant
Virginia Department of Taxation

Seen and objected and excepted to:

/s/ Michael J. Kator
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Counsel for Plaintiffs

/s/ George J. Rabil
GEORGE J. RABIL, Esquire
5321 Truman Avenue
Alexandria, Virginia 22304

Local Counsel for Plaintiffs

APPENDIX D

Pursuant to Supreme Court Rule 14(a), set forth below is a complete list of petitioners.

Henry Harper
Vincent R. Agnelli
W.P. Alexander
Eugene K. Allen
Jasper D. Alspaugh
Ralph E. Andrews
Ray and Eloise Appel
Mary S. Bailey
Edward B. Ballard
A. Jackson Barden
Raymond R. Barkalow
Philip Barsch
Raymond E. and
C. Louise Bauer
Rex W. Beasley, Jr.
Charles R. Beatty
Richard L. Bell
Alva O. Benson
George L. Beyer
R.J. Bishop
Harold G. Blodgett
Elwyn E. Bobbitt
Donald Boegehold
Fred Bone
Helen A. Boone
Herman Boschen, Jr.
Mack W. Bradley
John G. Brady
George Brinkmann
George K. Brite
Helen K. Brock
William H. Bryce
Glover N. Buck
Min Bunch
Y. Kirk Burch
Warren R. Burton, Sr.
Hal H. Bush
Mary C. Calhoun
Joseph Carretta, Jr.
Roy N. Carter, Sr.
Augustus Cartos
Josephine A. Clark
Mr. and Mrs.
Russell R.S. Clem
Paul Comisarow
Patrick J. Connolly
Joseph Connors
Mrs. Marian Canady Cooper
Raymond and Evelyn Copple
Charles F. Corns
Ida M. Costello
Christy W.M. Cottrill
William H. Craig
Davis H. Crawford
Mildren E. Critchlow
Mrs. Luch Cuthbertson
Anthony J. Daniels
Edwin E. Davenport
Christine E. Davis
Samuel T. Deal
Roger E. Demers
William A. Denin
William L. Desonia
Kathryn N. Detwiler
Norma Diaz
George H. Diggs
Donald P. Dollens
Joseph P. Donahue
Patricia H. Donnelly
Percy and Ruth Dowdy
Herbert A. Doyle, Jr.
C. Norman Draper
Eldermae Duff-Parker

A. E. Duke
Alfred J. Dumas
Harold Durham
Bernard L. Dyer
Mr. and Mrs.
W. Rogers Eakle, Jr.
Allen J. Earnhardt
Elidia T. Edwards
Robert E. Ela
Anna B. Elcan
Donald M. Elliot
Charlie A. Elliott
Clyde W. Elliott
James Elmore
George W. Ema
Arthur Emory
Donald R. Engle
Raymond L. Etheridge
Dorothy H. Eubank
Jean M. Evans
Isabel W. Fambrough
Alfred T. Farrar
George T. Farthing
Edward T. Fazzi
Helen C. Feagans
Ellen G. Findlan
Sydelle A. Fine
Bettye Fitzhugh
Richard Foote
Jerry G. Foreman
Katherine A. Frankhauser
Richard Frederick
Nelson Freeney
Charles R. Fullenkamp
Joseph Fulton
Adam Gardner
Melvin L. Garrett
William T. Gavan
Athol George
Ellis A. Gerald
Alfonso R. Gil
Humphrey Gilbert
Mr. and Mrs.
O.W. Gilbert, Jr.
Jean Gilman, Jr.
Bernard H. Gollinger
William B. Gorski
Aubry Lee Graham
Airleen E. Gray
George A. Greenfield, Jr.
Raymond W. Gregory
Anne D. Gucwa
William J. Gudell
Harry W. Haase
Claude E. Hale
Raymond S. Hall
Granville L. Hall
Robert P. Halpin
Karl H. Hanna
Verna W. Hasty
Erskine H. Hatfield
George N. Hathaway
Helen G. Hauenschild
John Hauenschild, Jr.
D. Craig Hawkins, Sr.
John R. Henry
Stanley H. Herbert
Martha W. Herron
Jack D. Hiatt
Mary B. Hickman
Mrs. Leonora E. Higgs
James M. Hildebrand
Samuel C. Hill
Gladys H. Hirdler
Bertie E. Hislop
Mrs. Nancy R. Hobbs
William E. Holt
Oscar J. Honeycutt
James W. Horsley
Harvey M. Horton
Edward A. Howe
Arnold S. Hudgins

James Hughes
Mrs. Rae S. Hughes
Harry L. Hughes
Mark V. Hughes, Jr.
Norman Jack
Charles F. Janes
Paul J. Jehlik
Kenneth W. Jenkins
Clarence M. Johnson
Lewis R. Johnson
James E. Johnson
Charles E. Johnson
Calvin C. Jones
Marshall Jones
Edward A. Jones
Joan Jones
James F. Kaar
Wilson K. Kaiser
Jackson E. Kelly
Howard V. Kempter
Bowen K. Kennedy
Ernest F. Kerekes
Eileen W. Kerekes
Joseph E. Knight
Edward L. Knight
Natalie E. Kothe
E.H. Kracker
Robert H. Kranich
Harold E. Krueger
Henry F. Kupiec
Ann C. Kyker
Helen A. Lajewski
Henry C. Lajewski
Robert E. Lamont
Kenneth E. Lantz
Iva N. Lany
Elizabeth R. Laughan
Prentice A. Layton
Corinne Le Bovit
Joe J. Lea
William M. Lee
Harold A. Leibert
Mary Leland
Philip Levin
Leigh K. Lewis
Henry C. Lind
Mrs. Margaret Lindsay
Earl M. Logan
Raymond J. Long
June S. Long
Mary Ann Lucas
Andrew Al. Luhtanen
Phillip C. Lupo, Jr.
Donald W. MacCloskey
Moselle C. MacCloskey
Edgar Madison
Herbert P. Malkus
John A. Marshall
Wesley R. Martin
John M. and
Dorothy S. Martin, Jr.
Thomas J. Mason
Roland L. Mason
Manfred C. Massa
Harlin W. Matkins
Vincent Maturi
Annie B. May
Robert J. McCauley
James E. McClain
Hampton McGhee
Lucille R. McGhee
John McGinty
Paul E. McGraw
Dolores A. Meier
Ellsworth D. Michel
Harry P. Mileham
Russell B. Miller
Thomas J. Mills
Joseph Mirabella
Miss Ruth E. Mitchell
Rolandus Mock
Evadne S. Molineux

Miss Pinala W. Monroe
Eleanor H. Moore
J. Herman Moore
Georgette C. Moore
Joanna H. Morris
William G. Mount
Claire J. Mueller
Phyllis Muhleman
Charles J. Murphy
Rose S. Musumeci
Wilma E. Neighbarger
Lester Newhouse
Elmore L. Newlon
Clifton A. Niles
Marian O. Norby
Majoria C. Norton
William P. Nothnagel
William R. Nunn, Jr.
Joseph E. Oglesby
Russell Oliver
James E. Owen
Mrs. Gay H. Packett
Clarence H. Pals
Benny L. Parker
John H. Parker, Jr.
Tom D. Parr
Harold S. Parrott
Richard D. Patterson
William T. Paynter
Claremont L. Pederson
Lewis W. Peery
Rena A. Perley
Joe W. Peterson
Edward W. Peterson
Jerome Pietrosewicz
Margaret M. Pilkington
John E. Pipes
Charles H. Pittman, Sr.
Thomas W. Poland
Marian C. Poland
Andrew G. Polaschik
John H. Porasky
Ransom L. Porter
Andrew J. Prokop
Martha M. Purcell
Zella Purser
Ernest C. Quillen
Modene Reed
Robert K. Reynolds
James C. Richards
Burnette L. Riddick
John M. Roberson
Wayne G. Roberts
Charles F. Roberts
William L. Roberts, Jr.
George R. Rodericks
Gleason Rohlfs
John J. Ronan
George H. Rose
Ralph K. Rowe
John P. Rowley, Jr.
George F. Sams
Richard P. Sargeant
Ophine Saunders
Rose E. Schafer
Arthur M. Scheid
Wallace E. Scherer
Lou Schottler
Samuel Schulman
Merva E. Schweikart
James J. Scordellis
John M. Scott
Wesley W. Scott
Boyd M. Sears
Guy H. Seaver, Jr.
Paul Seebold
Mrs. Grace E. Sharp
Edward C. Shepard, Jr.
Frank S. Shott
Ruth L. Simmons
Donald F. Simpson
Mr. and Mrs. Hayden Smith

Peter A. Smith
Lloyd G. Smith
James Smith
Raymond Smith
Frank L. Smith
Felix Sparks, Jr.
Ross Spattifor
Alan T. Spiher, Jr.
Norman E. Spiro
Edward E. Springborn
Helen I. Spurway
John R. Staklo
Carlton L. Stallings
Frederick H. Stein
John L. Stephenson
John Stevens
Carlos Stewart
John R. Stipp
Mary Evans Stipp
Russell I. Stith
Alton L. Stokes
Raymond W. Stokes
Paul Strickler
Luther and Ann Stringham
Robert L. Stubblefield
Herbert Sufit
Lewis R. Sugg
Thelma H. Swann
Walter M. and
Shirley T. Quitter
James T. Taaffe, Jr.
Flory J. Tamanini
Edward B. Tankersley
Carl B. Tauer
Remus H. Taylor
Margaret E. Tennis
Mr. and Mrs.
Fred D. Thacker
Rubie D. Thibodeaux
Monique F. Thur
John H. Tillage
Thomas A. Tinsley
Thomas A. Touhy
Mr. and Mrs.
Paul E. Towberman
Ermina Tucker
Naomi W. Turner
Miss Susie R. Tutwiller
Mrs. Hannetta Vaughn
Edward C. Vogel
Carolyn M. Vorwerk
Mary C. Wade
Walter Waleski
Darrel Walker
John W. Walker
George J. Wallace
Robert G. Wallenberg
Nancy B. Walsh
George H. Walter
Willard Ward
Mack Ward
Hallet M. Ward
Fred A. Watkins
John A. Watts
William P. Weathersbee
Catherine I. Weaver
Clifford L. Weaver
Wilfred H. Weisberger
Raymond C. and
Mary O. Weissenborn
Edward O. White
Mrs. Elizabeth S. White
Mrs. Dorothy L. Whitehurst
Howard Whitney
Charles M. Wiggs
Elizabeth Williams
Monroe W. Williamson
Miss Louise V. Willis
Jean L. Wilson
John R. Wilson
Leonard G. Wilson
Elizabeth Putney Winger

Hazel M. Winger
Harry B. Wirin
Bess Wisniowski
Ralph O. Wood
Ruy R. Yanello
Yuell Chandler
and Young Yee
John B. and
Frances P. Morris
George J. and
Helen T. Rabil
Raymond Webster
John C. Chapman
Jack Mayer
Alvin T. McConnell